

Insights and Foresights into 2010

By Ron Surz
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Even if you're on the right track, you'll get run over if you just sit there.
Will Rogers

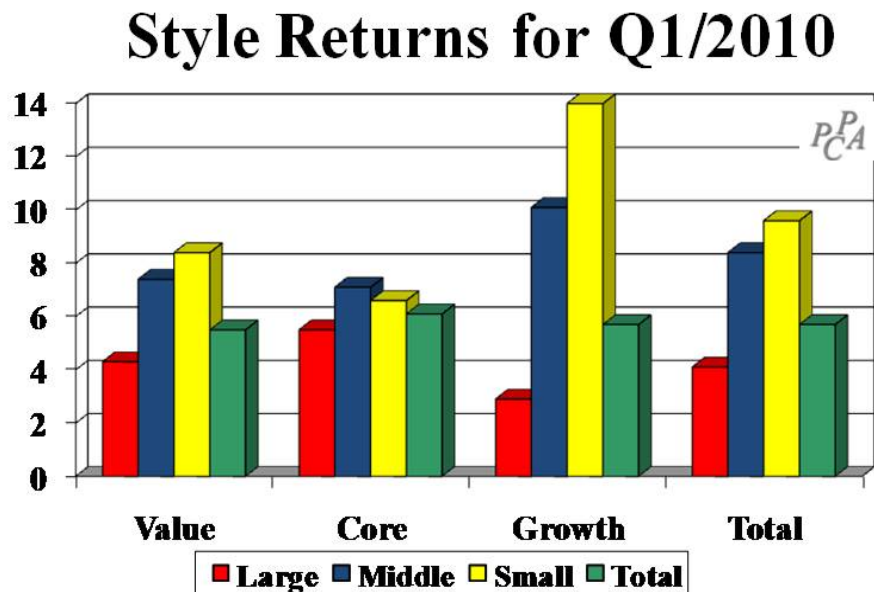
Introduction

As we begin this new decade, we breathe a guarded sigh of relief regarding first quarter stock market results. We've started out reasonably well, so perhaps we're on the right track. In the following commentary, I offer insights into the performance in the first quarter across styles, economic sectors and foreign countries. Then I provide three foresights that you can use for a long time; so you can consider moving down the right track(s).

Insights into the first quarter of 2010

The first quarter of 2010 did not start well, with US stocks experiencing losses in excess of 3% in January, but then we recovered most of those losses in February, setting the stage for 6%+ returns in March. All of the first quarter return was earned in March.

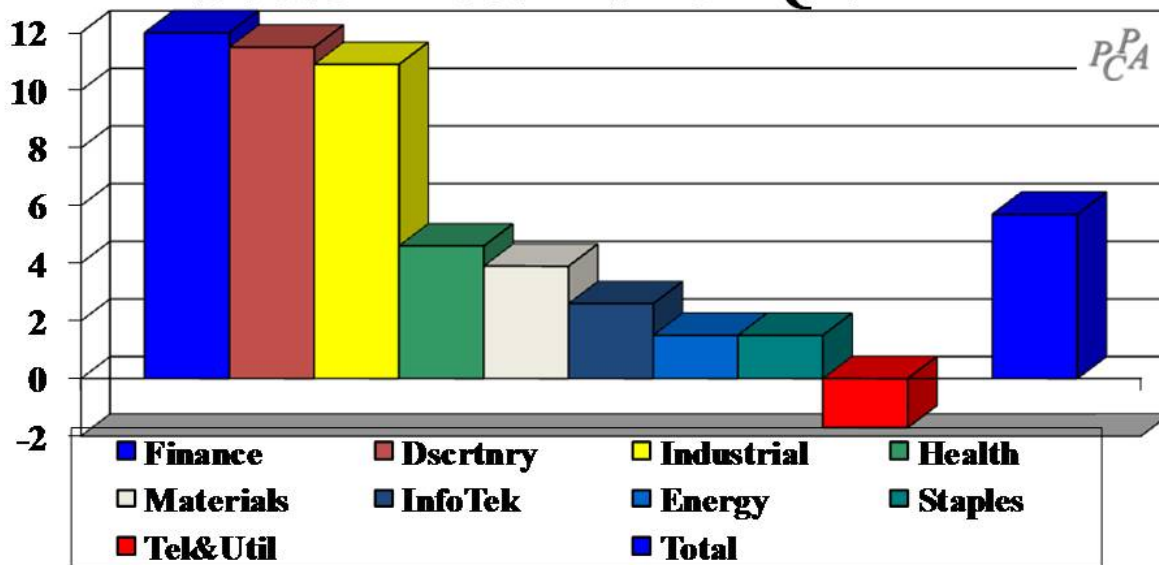
As the chart on the right shows, every US style posted a positive return for the first quarter of 2010, continuing the recovery that began in March of last



year. This quarter's 5.7% market return brings the 13-month return from March-to-March to a whopping 66%. It would seem that we're on the right track. Smaller companies fared best, while all three styles – value, core, growth – fared about the same in aggregate. I use Surz Style Pure[®] style and country definitions throughout this commentary, as described [here](#).

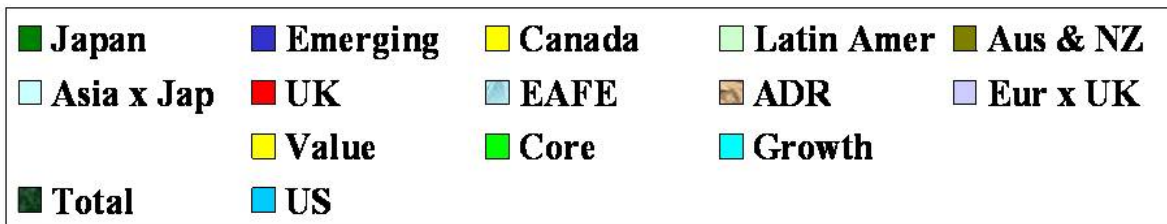
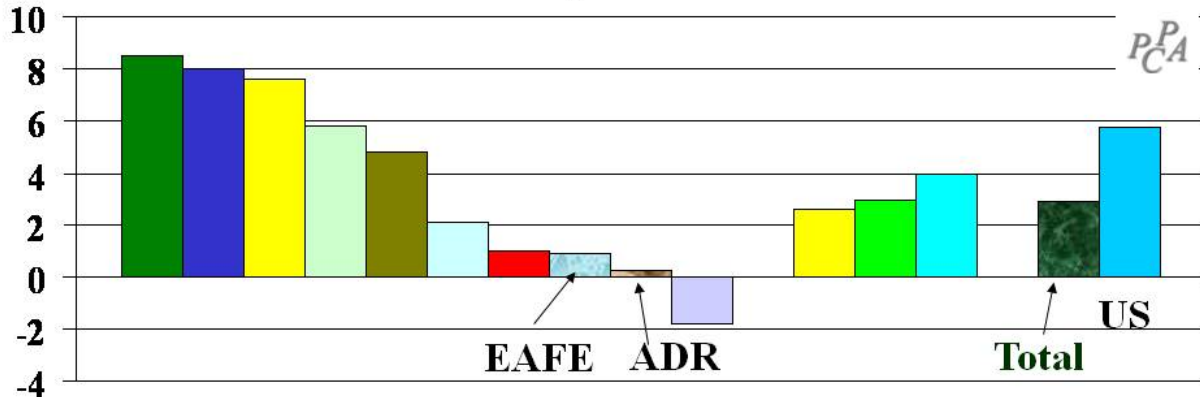
On the sector front, Finance came roaring back with a 12% return, followed closely by Consumer Discretionary and Industrial stocks. Other sectors earned mid-to-low single-digit returns, except Telephones & Utilities which lost 2% in the quarter. Although it's not shown in the chart, cross-sectional volatility was highest in Consumer Staples, indicating a wide performance spread across individual stocks in that sector. That distinction had been held by Financials for most of 2009.

Sector Returns for Q1/2010



Now let's look outside the US, where 2009 market performance far exceeded domestic returns. The first quarter of 2010 was a different story, where foreign markets lagged the US due entirely to currency effects, as the dollar strengthened. Total foreign markets earned 6.7% in local currencies but only 2.9% in US dollars, about half the US market return. Japan led the quarter with an 8.5% USD return. Europe ex-UK was the only region that lost money, declining 1.8% in the quarter. EAFE and ADRs lagged because of their larger company orientation. Large companies (not shown in the exhibit) earned 1.8% in the quarter while mid- and small-caps returned 5.5% and 6.3% respectively. Unlike the US, where core was in favor, growth stocks fared best outside the US.

Country Returns

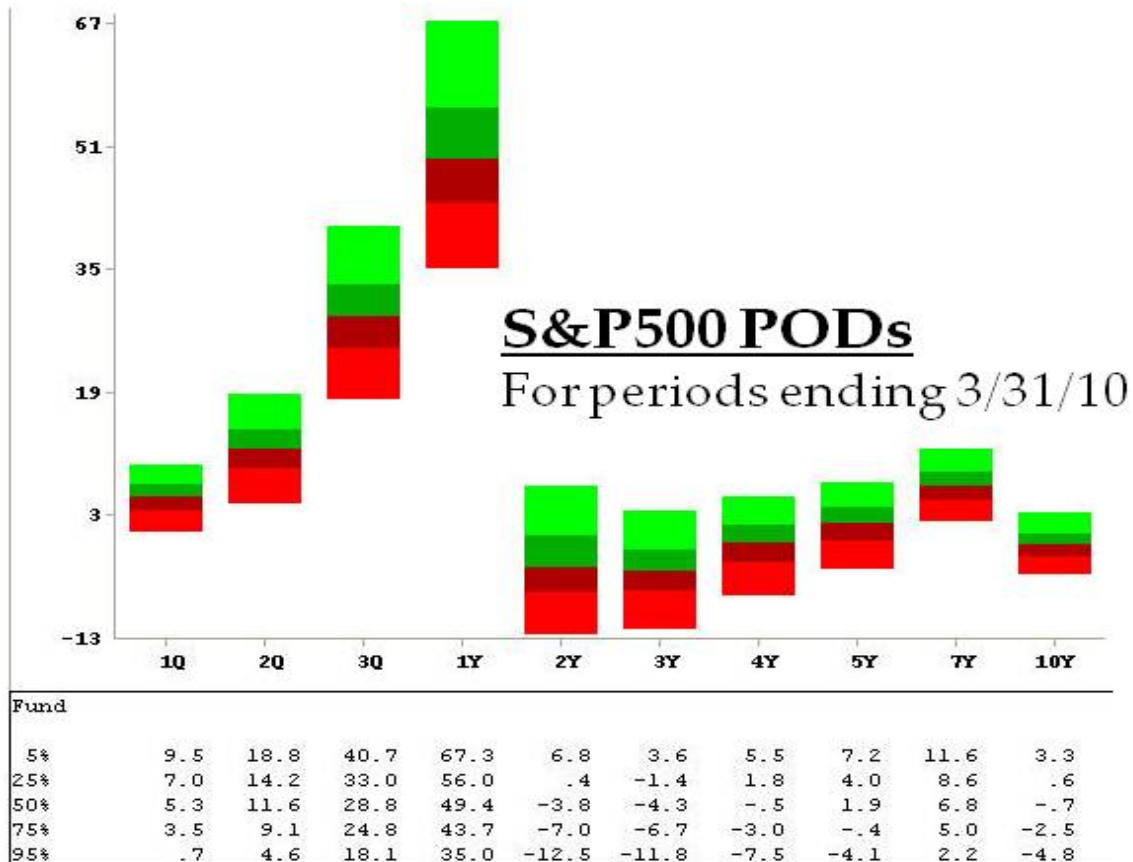


Foresights you can use in 2010 and beyond

Here are three approaches you can use now and for the foreseeable future.

Unbiased Peer Groups

Most advisors know that traditional peer groups are pathetic barometers of success or failure, but they still believe that there are no better choices. They're wrong. Portfolio Opportunity Distributions (PODs) represent all of the possible portfolios that managers could have held when selecting stocks from the indicated markets. In the following exhibit we provide PODs for the S&P500. Performance numbers for periods ending 3/31/10 are available now, but most peer groups won't be released for a month. Use the table and graphic below in the meantime to evaluate your investment managers. Note for example that a return of 40% for the year ending March, which would appear to be good on its surface, is in fact bottom quartile. But extend the time frame out 2 years or more and a mere 1% return is a top quartile winner.



The Next Generation of Style Analysis

Style analysis has entered the 21st Century with Style Scan. Literally "see" the styles of your favorite indexes and portfolios as they've never been seen before at <http://www.ppca-inc.com/StyleScan/Demonstration.aspx>. Every stock, and the total portfolio, is plotted in style space (large-small, value-growth).

My gift to you is FREE access to this invaluable tool. In addition to the education, the application is fun and actionable, as follows:

Educational

See the holdings of your favorite index or portfolio in style space. Returns-based analyses cannot even begin to provide this insight and detail. Yes, the index data is publicly available on the Barclays (now BlackRock) website, but that's not the big deal. The big deal is that you can paste your own portfolio into the box provided at the top of the control page, or just pick a few stocks you know well.



Choose your style definition. It makes a big difference, especially in this economic mess. For example, securities with negative earnings are generally classified as growth with the Surz Style Pure® approach, but value by the Price/Book approach. The difference in perspective is speculative versus cheap, since the prices of these stocks have fallen. Many stocks in the Financial sector are affected. A corollary: your choice of style palette in returns-based analysis matters a lot, but that black box can't tell you about the problems.

Fun

Click on a dot to see its name and allocation – what are those stocks in the corners, at the top, etc.?

Click on an economic sector in the pie chart and see these stocks light up across style space. Not all Financials are value, nor are all Tech stocks growth.

Actionable

Fiduciaries can compare the style signatures of one manager to another in order to understand in detail their similarities and differences. This is like seeing both on an MRI, hence the word “Scan.”

Investment managers can fill voids and reduce redundancies by simply noting blank spaces and clusters.

In a future extension, we'll provide a “move your star” functionality that will offer trading suggestions to get from the current style location to another.

Fiduciary or Salesman?

We all want to do what is best for our clients and to get paid for that guidance. Therein lies a potential conflict; clients are sometimes unwilling or unable to pay what your service is worth. I help you decide which is best for you when it comes to target date funds, the most rapidly growing segment of the defined contribution investment industry: fiduciary or salesman. Click [here](#) for my guidance.

Ron Surz is President of PPCA Inc at www.ppc-inc.com and its subsidiary Target Date Solutions at www.TargetDateSolutions.com



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